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TAGS: ECON EFIN ELAB ETRD KE
SUBJECT: KENYA: PRIVATE SECTOR SAYS THE ECONOMY WILL SHRINK IN 2008

REFS: (A) NAIROBI 336 (B) NAIROBI 192

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¶1. (SBU) Summary: The private sector is warning that the Kenyan economy will likely shrink in 2008, having already lost tens of billions of shillings in January, and with losses that could reach Ksh260 billion (over $4 billion) and 500,000 jobs in the first half of the year. Claims by Government of Kenya (GOK) officials that the crisis is just a temporary blip and that the economy can still grow at 7% in 2008 appear to be a cheerleading effort to maintain public and business confidence. The sharp drop in the Nairobi Stock Exchange (NSE) and the shilling suggests their efforts are failing to impress the private sector. Facing these economic challenges may have helped persuade President Mwai Kibaki and Opposition LeaderRaila Odinga to meet and announce the start of the negotiation process. End summary.

Private Sector's Grim Forecasts

¶2. (U) The Kenya Association of Manufacturers (KAM) said January sales volumes in the manufacturing sector fell 90% below normal, as the sector was disrupted by congestion at Mombasa port, road insecurity, and fuel shortages linked to the post-election political violence which erupted in late December. Based on anecdotes from members, KAM estimates that, absent a quick political settlement and return to normality, economic losses from reduced production in the first half of 2008 will reach Ksh260 billion (over $4 billion), about 500,000 jobs will be lost, and that GDP would experience negative growth in 2008, even if the second half saw growth at 2007 levels. Even in a more optimistic scenario in which higher operating levels brought estimated losses below Ksh 200 billion (about $2.86 billion), 2008 GDP would still see negative growth.

¶3. (U) Based on an informal survey of its 2,500 members, the Federation of Kenyan Employers (FKE) estimated they have already lost Ksh58.2 billion (about $90 million). Even if there were an immediate political settlement, about 90,000 people will be laid off. If there is no political settlement within two weeks, businesses will lose Ksh230.5 billion (about $3.3 billion) in the first half of 2008, and lay off 240,000 workers. While many companies indicated they would minimize income and job losses if there was a quick political settlement, Executive Director Jackie Mugo said the economy would otherwise go into free fall.

GOK officials Try to Reassure Public and Investors
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¶4. (U) Responding to fears that Kenya's 2008 economic growth would dip far below the forecast 7%, Central Bank Governor Njuguna Ndung'u on January 10 downplayed the impact of the violence, calling the crisis a short disruption that would not have a major impact on GDP growth. The dip in growth will not signal a recession nor change Kenya's strong long term growth trajectory because of Kenya's strong fundamentals, but he conceded that supply constraints would trigger inflation in the short term.

¶5. (U) Ignoring private sector warnings of a massive impending downturn, Finance Minister Amos Kimunya claimed on January 29 Kenya would suffer only a slowdown in economic activities in the first six months of 2008, not a recession. He said that Kenya's fundamentals were still sound, and that sectors other than tourism would recover quickly after a solution is found to the political crisis. Kimunya acknowledged that the tourism sector, which garnered $1 billion in hard currency for the first time in Kenya's history in 2007 (ref A) and generates an estimated Ksh65 billion/year, would take longer to recover. Kimunya accepted that revenue collection would fall below the FY07/08 target of 406.9 billion shillings (about $6 billion) in 2007/08, but claimed the Ksh8 billion surplus tax revenues (about $118 million) collected in the first half of the year, plus the extra Ksh20 billion (about $294 million) collected in the Telkom privatization would cushion some of the shortfalls.

Renewed Violence Smashes Slow Return of Normality
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¶6. (U) Violence died down the week of January 21, and people began to feel normality was returning, but this faint revival of confidence was aborted by the sudden January 26-28 attacks in the

previously peaceful South Rift Valley towns of Nakuru and Naivasha, road and rail blockades, the murder of an opposition MP in Nairobi, and the resulting violence in Nairobi's slums. The attacks on flower farm workers around Naivasha and on buses and trucks at roadblocks on the Nairobi-Uganda highway threatened the critical flower industry at the start of the peak Valentines Day season. Shaken by the violence, the NSE's market capitalization plunged Ksh40 billion (about $570 million) or 5% on January 29. The NSE-20 share index fell by 235.5 points (5%) to close at 4576.3 points, a drop of 14.3% from its December 21 level of 5339.75. On January 30, the NSE recovered some of its lost ground, buoyed by the Kibaki-Odinga agreement to start negotiations, but investors remain skittish. On January 29, the shilling fell 4.1% to 72.75/$, and fell 4.2% to Ksh107.59/Euro. As of January 30, the shilling has fallen 16.3% since its December 2007 peak of Ksh62.54/$, and most analysts predict it is likely to stay above the Ksh70/$ level.

Comment

¶7. (SBU) Although GOK officials have not yet publicly acknowledged the crisis' damage to the economy, it is likely that private sector warnings, the January 26-28 violence, and the plunging stock market and shilling helped persuade President Mwai Kibaki and Opposition Leader Raila Odinga to meet and announce the start of the negotiation process. If they can reach some preliminary agreement within a few weeks, and make strong efforts to rein in the violence, the economic damage may be minimized, and recovery could begin. If negotiations drag on too long, and/or if political leaders find that the violence spirals beyond their control, Kenya could face a major economic downturn in 2008.

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